

Klaus Regling in interview with Delo (Slovenia)

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10/02/2018

Interviews

Interview with Klaus Regling, ESM Managing Director

Published in *Delo* (Slovenia), 10 February 2018; interview conducted on 2 February 2018

Interviewer: Miha Jenko

Delo: Mr. Regling, you manage the ESM, the crisis resolution mechanism for the eurozone countries. Do you feel less busy now since there is no crisis in any euro country and the ongoing process in Greece - where the ESM is now preparing the disbursement of the fourth tranche to Greece, the total amount will be €6.7 billion - proceeds relatively routinely?

Klaus Regling: Life is easier now, as we are out of the crisis. It is positive that our work – but also the reforms undertaken by the countries that needed support - has been successful. In the last seven years, the ESM and its predecessor the EFSF have disbursed €273 billion to five countries. Four out of the five are clear success cases now. Greece is still in the programme. But they will exit in August this year. And if they continue to implement reforms, there is a good chance that Greece will also become a success case. So it is very positive that work there is almost finished. Now our work is focused on the future, how to make the European Monetary Union more robust and less vulnerable and that includes also some ideas in developing the ESM.

Where do you see the main risks and challenges the eurozone is facing at the moment?

At the moment the economic situation is very good. Annual GDP growth rates at around 2.5% for Europe are very good, particularly in the light of our demographic situation. Growth rates will not stay at this level, we know that. The potential growth rate - as a long-term trend growth - is just half that level. Growth will come down eventually, when the output gap is closed, as the economists say. Therefore it is important to implement reforms to strengthen the growth potential. That means more investment in education systems, better training possibilities, more structural reforms in some countries. That is the main challenge - to strengthen the growth potential, because our demographic trends are not good. All growth has come through productivity gains and we have to make sure that we can move in that direction. Today, there is a risk of complacency because the economic situation at the moment is very good and the efforts to improve it will weaken.

The name of the game in Europe now is »deepening« the European monetary union, which sounds like the new catch phrase. How do you explain it in simple words?

There are many ideas on the table. We know the European Commission has made proposals, President Macron gave his speech, governments are talking, academics are making proposals, so there are many ideas. At the summit of the euro area countries last December, the President of the European Council, Donald Tusk, concluded that there are two areas where he sees a lot of convergence and therefore he asked the euro area finance ministers to focus on them. These two areas are completing the European banking union and developing the ESM. Completing Banking Union means to develop the European deposit insurance scheme and the second element is to have a backstop for the Single Resolution Fund for banks. The euro area ministers will work on that. There is a large consensus that a deposit insurance scheme is useful for the functioning of the monetary union, but certain conditions have to be in place.

Yes, which conditions should be fulfilled? We know that certain »northern« euro area countries are very sceptical about how this scheme may be applied in the future. Your view?

Countries are not sceptical about deposit insurance as such - there is a broad support for that - but about the conditions and how quickly it could be in place. That is where we don't have a common view yet. That is where we have to work and the

conditions are all related to legacy problems of the past. And for some member states that includes the amount of non-performing loans on the balance sheets of banks. One can also look at the wide variety of insolvency laws across Member States. So there are many issues that some countries consider risky. But we will work on that in order to make the deposit insurance possible.

What about the transformation of the ESM to the EMF, European Monetary Fund, which is an idea in progress now. How achievable is this project?

Again, there is a debate and the summit concluded that this is an area where it should be possible to come to some conclusions in June this year. One of the ideas is that in the future – when or if there is a new crisis in a eurozone country – the ESM, together with the European Commission, will be responsible for designing and negotiating an adjustment programme, including the conditionality. So far, we have not done that very much. When the crisis happened a few years ago, we had the troika (EC, IMF and ECB) to work on this. In the future it looks that some of this could be done by the ESM, of course together with the Commission. That would be an important additional mandate for us, which could also lead to a new name. But the new name is not very important. It is the substance that counts. In addition, the ESM would probably be asked to provide a backstop for the Single Resolution Fund.

But is there any timeline when the ESM could be formally transformed in the EMF?

If everything goes well, there could be the political decision to do that in June, when there is another summit of the euro area. The implementation then would take time, because it requires changing the ESM Treaty. It is possible, but it requires a unanimous decision and ratification in all 19 parliaments of the euro area member states. So it would take some time.

Bundesbank President Jens Weidmann pointed out in the recent interview for Les Echos that the ESM should have more influence in budget supervision, which would help bring an end to the conflict of interest inherent in the European Commission. He also suggested the ESM should be responsible for examining the situation of member states' public finances, preferably on the basis of simpler and clearer regulations. Do you agree?

I think one has to be careful how far we can go. As I just said, I see that the ESM could be asked to negotiate adjustment programmes together with the European Commission. That also means that we should be well informed on a regular basis on what happens in all of 19 euro area member states. But as far as economic and fiscal surveillance and policy coordination is concerned, the EU Treaty gives this competence to the European Commission. Taking it away from the EC would therefore require a change in the EU Treaty – which is a very difficult and very long-term proposition. I am not advocating that. So one has to be very careful what is possible and what is not. I am looking more for a clear mandate to work together with the Commission on monitoring all euro countries in order to be ready to negotiate adjustment programmes with countries in case of a crisis. But we should respect the prerogatives given to the Commission by the EU Treaty.

On the table there are also ideas proposed by French President Macron - for the fiscal union, a sizeable eurozone budget, a common euro area finance minister. This idea will be discussed also by the German side in the near future. What is your view on these ideas coming from Paris?

There are many ideas on the fiscal side, not only from Paris, but also from the Commission and some other member states, academics etc. But as I said at the beginning, the summit agreed on two areas – banking union, the ESM – where there is already more convergence. Other issues – and they are mainly on the fiscal side – need more time to be discussed and developed. Some of them are very controversial: for example, there are proposals to have a line in the EU budget only for euro area countries, for macroeconomic stabilization, to promote investment or to support structural reforms.

And to fix the consequences of asymmetric shocks in particular eurozone countries...

Yes, that is one of them. There are many ideas, but at the moment they are controversial. So I would not expect that by June we will be able to come to conclusions on these issues, and that also includes the idea of a European finance minister. I think a debate on all these ideas will follow after we have worked on these two elements where there is a large consensus, in other words completing Banking Union and strengthening the ESM.

So, do you think that all these difficult, controversial and also political questions should be somehow postponed beyond the European elections next spring?

I wouldn't want them postponed, because one should continue to discuss them. But it seems to me – looking to the summit last December – that certain areas (Banking Union, ESM) are more ready for a decision. So I would expect decisions earlier in these areas than in the other areas. The work and discussions will continue, but my feeling is that decisions on this will come a little bit later. How late, I cannot say at the moment. But you are right, in 2019 everybody will be very busy with the elections.

As for the Banking Union: how sound and firm are the European banks at the moment?

A lot has been done during the crisis. European banks have doubled their capital in last ten years. That is a big number, almost €700 billion of additional capital. Additional regulations have been implemented worldwide, including in Europe. But there are still some problems, particularly in some banks. The profitability of European banks has improved, but it is still below the profitability of US banks. The amount of nonperforming loans has been falling now for three years, last year by 17 %, so there is good progress. But it is still high and there is a large amount of NPLs that should be worked on. So, the situation is better today, but the work is not over and the situation varies from country to country.

Slovenia was also hit hard by the crisis and is dragged down by high NPLs. How do you see the situation in our country now? What is your comment on the current macroeconomic situation? What are our main challenges ahead (public debt, privatization, productivity, demographic trends)?

The overall situation - like in many parts of the world - is good. Growth is much higher than expected, also 2017 was much stronger than 2016. That is positive. The fiscal situation is also good, a balanced budget is expected for this year. But of course, there are challenges, like NPLs. They need to come down further. Ageing, demography is also an issue in Slovenia. But one needs to focus on productivity gains that could enable better growth rates and potential growth in the future. At the moment, growth in Slovenia is good, but it will fall back, so you need to focus on

productivity. Privatisation is a way to make an economy more efficient. So these are the challenges.

In the last weeks Slovenia had a tough discussion with the European Commission regarding the privatisation of NLB, the Commission has opened an in-depth investigation to assess new measures, proposed by the Slovenian authorities. What is your view/recommendation on that?

I am not familiar enough with the details of individual banks, so I cannot give any advice on that.

You've been a guest at the recent conference on Deepening of the Monetary Union in Slovenia, where former Slovenian minister of finance Dušan Mramor pointed out that the fiscal and monetary policy in the euro area is suited only to so called core countries and that periphery countries should be given more place to neutralize crisis and economic shocks. Do you agree? What is your view on these issues?

I do not agree with that analysis. I believe the euro contributes positively to economic developments in all member states of the euro area, regardless of their size, and whether they are part of the core or the periphery. Economic challenges may differ country by country. But small open economies benefit in particular from the euro, because they are not really able to conduct their own monetary policy.

What about those non-euro EU members (with the exception of Denmark and, of course, the UK) that are expected to adopt the euro in the future? How fit and willing are they to join euro?

According to the EU Treaty, it is an obligation of every EU country, except Denmark and the UK. At the same time, nobody will force them to do that. My expectation is that all the current EU members – with the exception of Denmark and the UK – will adopt the euro over the next decade, maybe in 12, 15 years. Some countries want to do it sooner, like Croatia, others are still considering it, like Poland and Hungary. It is understandable, since we had a deep crisis in last few years. But now that we are out of the crisis, it is very obvious that being a member of the euro area brings certain advantages. I think Slovenia also feels that and that would be an example to follow for the others.

The Franco-German axis is considered the core of the euro area and the talks about the future of the euro area are now delayed due to a long process of formation of the new German government after the elections last September. Do you expect that this axis will be operative in the course of the next months?

It is correct that France and Germany are important because together they account for half of the economic size of the euro area. But on the other hand, all the important decisions have to be taken unanimously. So it is not enough that France and Germany find an agreement. It is very important to include the other countries and I think this is what France and Germany will do. But it is true that at the moment, without a new German government in power, there are delays. We are all waiting for the moment that the German government is fully able to participate in the discussion. I think once that happens, there will be the possibilities for Germany and France to agree on certain elements. We are grateful that President Macron has developed a vision where Europe might move. There will be discussions between France and Germany, but then it will be important to include all the countries in this debate.

The European Central Bank decided on 26 October last year to scale back its bond-buying, but did not say when it would terminate the programme. Do you see any major obstacles to a return to a normal monetary policy of the ECB at the moment?

I think the first step has been taken. But I can't say anything about the timing. The ECB is independent, but clearly, like in the cases of other important central banks, for example the Federal Reserve or the Bank of England, the way towards normalisation has started and it will continue.

The ESM provided financing to Greece, Ireland, Portugal and Cyprus and helped recapitalise some Spanish banks so far. But does the ESM have financial capabilities to financially support a major eurozone country if it is in serious trouble?

This is a hypothetical question. I don't see any country needing our help now or soon. But I think one should look at our unused lending capacities, almost €400 billion. This is a big number and that is enough to cover all potential needs.

Mr. Regling, in 2011 you were publicly mentioned as a possible candidate for the successor of then ECB President Mr. Trichet. Eventually Mr. Draghi was chosen and his mandate expires next year. Do you think that it is the time now that the ECB gets its first president from Germany next year?

I have worked many, many years on European issues. I am very much in favour of not giving too much importance to nationalities for important positions in Europe. So that is not the main criterion for me. It has to be a competent person and I am sure we will find one.

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